

Fail to Prepare? Prepare to Fail

The following article is based on the recent IAVI seminar delivered by **Denis Murphy**, Senior Manager, Corporate Finance, Deloitte. The seminar focussed on the role of the professional in business plans for NAMA.

Introduction

NAMA is currently taking ownership and management of €81bn of development loans from the five participating Irish banks. As part of this process, NAMA has requested developers to prepare a business plan under a predefined template which outlines the developer's vision for the properties and a proposed timetable for debt recovery. It is worth first discussing NAMA's activities thus far before the business plan particulars, as it provides an indication of the impact on asset values and the timeline available to developers to prepare their plans.

NAMA: the story so far

In May of this year, NAMA completed the acquisition of the first tranche of loans relating to the top ten borrowers from the five participating institutions, which amounted to just over €16 billion. The average discount on the loans was 46.9% as described in the table below.

If one were to apply the discount of 46.9% to the total debt of €81 billion, this represents a write-down of €38 billion for the five participating banks. This would require approximately €30 billion of additional finance to inject sufficient liquidity into the banks, of which circa €20 billion has already been raised- an indication of the proactive approach being taken to revitalise the banking sector.

The current market value of the property underlying the tranche 1 transfer was €9.44 billion at November 2009. If we assume (based on the NAMA Business Plan for all loans) that the average loan to value (LTV) of tranche 1 debt of €16 billion was 77% at the time of original lending, the original market value of the associated properties would have been in the region of €21 billion. The current market value of €9.44 billion therefore represents an average 55% fall in property values from peak levels.

One of the things that has become increasingly clear during NAMA's loan due diligence is that due process was another victim of the property development bubble; much of the

	AIB €'bn	BOI €'bn	EBS €'bn	INBS €'bn	Anglo ¹ €'bn	Total €'bn
Loan balances	3.29	1.93	0.14	0.67	10.00	16.03
CMV of property	1.87	1.26	0.10	0.36	5.85	9.44
LEV of property	2.04	1.41	0.10	0.41	6.55	10.51
LEV uplift as a % of CMV	9.1%	11.9%	8.4%	11.8%	12.0%	11.3%
Total consideration	1.88	1.26	0.09	0.28	5.00	8.51
Discount	43%	35%	36%	58%	50%	46.9%

lending for the purposes of property development was carried out in haste and inadequately secured and documented. This poor documentation has contributed to the total consideration paid by NAMA of €8.5bn falling below the value of the underlying assets of €9.44bn.

As part of the first tranche of loan transfers, NAMA issued bonds to a value of €7.7 billion to help create much needed liquidity in the indigenous banking sector. The latest data for April 2010 from the Central Bank shows the pace of decline of credit to Non-Financial Corporations eased slightly in April, as the net flow of credit transactions during the month was minus €109 million, compared with minus €1.3 billion in March and €842 million in February. While it appears that the current liquidity constraints are easing, our experience is that credit from the participating institutions is still not available in the quantum required. This sentiment is echoed in the latest ISME Bank Watch Survey (June 2010). The survey reveals that 55% of SME businesses who sought funding in the last three months were refused credit by their banks. While these figures are disputed by the banks it is indicative of a funding market that is still very constrained.

What Happens When a Loan is Transferred?

When a loan is transferred to NAMA, the borrower is notified directly by the Agency and invited to submit their business plan within 30 days. An employee of NAMA is appointed as the relationship manager for the connection. Communication remains with the original bank pending NAMA's receipt of

the borrower's business plan. Requests for funding for ongoing projects or to meet costs continue to be submitted to the relationship bank who, in turn, seeks a decision from NAMA.

NAMA have estimated that the transfer of the remaining loans will occur as set out below which provides indicative dates for the submission of business plans.

It remains to be seen if this timetable will be met as NAMA has found it difficult to meet previous deadlines due to difficulties relating to documentation on the loans to be transferred.

Why Prepare a Business Plan?

A business plan template and data pack has been issued by the Agency to enable borrowers to outline their plans for individual assets. The plan is extremely thorough and based on detailed forecasts which need to be outlined in the data pack. Any borrower who believes that their loan(s) will be transferred to NAMA or has received confirmation of same should now begin preparing their business plan in earnest.

It is extremely important for the borrower to embrace the process and be proactive as decisions taken by NAMA in relation to the borrower's projects will be based, for the most part, on the business plan. The plan is also an opportunity for borrowers to gain the support of NAMA. From the Agency's perspective the Plan also:

- Gives NAMA a complete view of the borrower's overall debt exposure and, the structure and nature of the borrower's security.
- Enables NAMA to assess the feasibility of completing any projects still in the development phase and, if necessary, the funds to complete those projects.
- Allows NAMA to determine the borrower's short term funding requirements.
- Gives the Agency a good overview of the borrower's non-NAMA activities including borrowings from other banks.
- It identifies any assets or loans which may have been overlooked as part of the overall transfer of loans.

In order to validate the information contained within the business plan, NAMA have appointed a panel of accountants and estate agents to review the business plans on its behalf. NAMA have indicated that a simpler plan index will be issued for smaller borrowers in due course, however precise details are not currently available. Outlined below are the key areas in the current business plan index. These areas are likely to be required for all borrowers irrespective of size.

	Tranche 1	Tranche 2	Tranche 3	Balance
Estimated Date:	May 2010	June 2010	July 2010	By February 2011
Business Plan Due Date:	June 2010	July 2010	Aug 2010	
Loan Transfer:	€16bn	€13bn	€8bn	€44bn ²

Key Areas and Factors to Consider

The three main sections of the business plan cover:

1. Property Analysis;
2. Market Analysis, and
3. Financial information.

Property Analysis

This should outline the individual projects; have a cost-benefit analysis on development projects. A valuation should be performed for each asset both now and the expected value at the time of sale. The range of valuations should determine how and when the debt can be repaid. It is therefore essential that it is based on realistic market assumptions which will be heavily scrutinised by a member of NAMA's panel of advisors.

An analysis of current and future rental income is also required on a property by property basis including, but not limited to, an assessment of future rental and occupancy levels, voids and potential rent free periods or rent reductions.

Lastly, a realistic disposal programme should be drawn up to repay the debt which reflects the valuations described above. This plan needs to reflect the borrower's view on when best value can be obtained from the assets but should also be cognisant of NAMA's desire to see material debt reduction in the early years. We believe that NAMA's view is that assets should, realistically, only be retained for a long period where there is a compelling financial reason not to put them on the market.

Market Analysis

The market puts into context the forecast asset disposal / refinancing plan. The analysis needs to:

- Outline the current market conditions on both a local and national basis;
- Provide an outlook for the market(s) and how this is relevant to the borrower;
- Describe the level of competition from other sites in the area;
- Gauge the buyers appetite for the different properties; and,
- Be consistent with the valuations provided in the property analysis section.

Financial Information

The details of the valuations and rental income are fed into projections to calculate the amount of debt which can be repaid, and over what term. As before, detailed analysis is key. A forecast profit and loss and balance sheet are required. This generally involves developing and stress testing a detailed and

complex financial model outlining the asset performance both individually and in the context of the group.

Other sections in the plan deal with the complexity of the borrower's corporate structure, key members of the borrower's management team and a full and frank analysis of the borrower's security structure including details of any guarantees (personal or otherwise) that have been provided.

Conclusion

Borrowers should use realistic assumptions and forecasts when putting together the business plan. The base case assumptions should be prudent but not unduly pessimistic as they will be sensitised. Relying on a previous scheme which requires significant market uplift is a high risk strategy and is unlikely to gain favour with NAMA. Assistance from a Valuer is pivotal to the development of realistic assumptions for any business plan as they can provide rigorous analysis pertaining to the market which can be justified by economic fundamentals.

Realistically for many borrowers, NAMA may be the only supplier of capital for completion of development projects in the short to medium term which may be key to a successful workout of the debt. The business plan is an opportunity for borrowers to demonstrate the strength of their business and to gain the support of NAMA.

It is therefore extremely important for the borrower to embrace the opportunity and be proactive in their relationship with the Agency.

Preparation is crucial and a well prepared, realistic business plan will enable the borrower to illustrate their capabilities when meeting NAMA for the first time. The general tone of the initial meetings, and consequently the borrower's relationship with the Agency will be predicated on the credibility of the business plan. In this case, the cliché proves true – there will be no second chance to give a good first impression. ♦

FOOTNOTES

- 1 Subject to audit.
- 2 Figures sourced from: National Asset Management Agency – First Loan Transfers (press release) and Address by Frank Daly, Chairman of the National Asset Management Agency, to the CPA Annual Conference 2010